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HOUSE COMMITTEE ON
GOVERNMENT REFORM**

**TESTIMONY OF
ALAN F. ESTEVEZ
ASSISTANT DEPUTY UNDER SECRETARY OF DEFENSE
(SUPPLY CHAIN INTEGRATION)**

**BEFORE THE UNITED STATES HOUSE
COMMITTEE ON GOVERNMENT REFORM
NATIONAL SECURITY, EMERGING THREATS, AND
INTERNATIONAL RELATIONS SUBCOMMITTEE**

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**Overview of the Department of Defense
Excess Property Systems**

**Mr. Alan F. Estevez
Assistant Deputy Under Secretary of Defense
Supply Chain Integration**

Chairman Shays, Congressman Kucinich, and Members of the Committee:

Thank you for the opportunity to appear before you again and discuss the Department's Excess Property Programs. I am Alan Estevez, Assistant Deputy Under Secretary of Defense for Supply Chain Integration. In my position, I am responsible for developing Supply Chain Materiel Management Policy in the Department of Defense (DoD), which covers how the Department keeps our fighting soldiers, sailors, marines and airmen supplied with the materiel they need to fulfill their missions. Returns and reutilization are part of that supply chain, and the Defense Reutilization and Marketing Service (DRMS), a field command of the Defense Logistics Agency (DLA), and the Military Services are charged with implementing and executing our policy.

I appreciate the opportunity to provide an update on improvements we have made since the last hearing in June 2005 and to address the challenges highlighted by the Government Accountability Office (GAO) in their draft report, *DoD Excess Property: Control Breakdowns Present Significant Security Risk and Continuing Waste and Inefficiency*, dated July 10, 2006. I will discuss the solutions we are implementing to improve the return supply chain as it applies to reutilization and disposal.

I am proud to be joined today by Major General (MG) Bennie Williams, the DLA's Director of Logistics Operations, and Mr. Paul Peters, a new member of the Senior Executive Service (SES) and director of DRMS. The fact that we now have SES level leadership at DRMS is an indication of the resources we are devoting to the reengineering of our reutilization and disposal supply chain.

Before we discuss our efforts to improve the reutilization and disposal process, it would be useful to place it within the context of the broader DoD logistics enterprise, a \$151 billion operation. We support weapons systems engaged in air, land, sea, space and cyberspace programs around the world and feed and clothe over one million fighting men and women daily. The DoD logistics enterprise would be 9th on the Fortune 500 list if it were a separate company. DLA alone would be in or near the Fortune 50, or roughly the same size as companies such as Intel, Lockheed Martin and Microsoft.

The primary mission of the DoD supply chain is to ensure that the warfighter has the materiel required for his or her mission. I would like to take just a few moments to recognize the efforts of our DoD logisticians in supporting not only the warfighter, but a host of other missions as well. With the help of this Congress, the nation has crafted a world-class military logistics system. Over the past year, our uniformed and civilian logistics professionals have continued to successfully support complex military operations, including the ongoing operations in Iraq and Afghanistan, as well as humanitarian relief associated with the Pakistan earthquake, and the humanitarian relief along our own Gulf Coast. This group of dedicated and knowledgeable logisticians is the only group in the world that could have successfully undertaken these efforts. DLA

logisticians have played a critical role in all these support efforts, including providing over 5.1 million meal kits and bottled water to hurricane victims while simultaneously providing ongoing support to our forces deployed in Iraq and Afghanistan. In fact, a recent Joint Staff assessment rated DLA's support of our warfighters as excellent.

Even as we provide the levels of support at the scale referenced above, we are engaged in a massive effort Departmentwide to transform the operations of our supply chain. This transformation effort includes a comprehensive re-engineering of all of the processes which support logistics, increasing the skills of, and tools available to, our logisticians, and developing the information systems to support our improved processes and people. The results can be seen in such major achievements as:

1) \$400 million in cost avoidance through the efforts of DLA, working with the United States Transportation Command, the Distribution Process Owner, and U.S. Central Command to establish a supply depot in Kuwait;

2) a decrease of 33% between 2004 and 2006 in customer wait time, a key performance measure of the logistics system, which measures how long it takes the logistics system to deliver an item to the end user from the time he or she orders an item until it is received,.

While we have more work ahead of us, we are proud of what we have achieved to date.

Reutilization and the DoD Supply Chain

An important part of the DoD supply chain is the 3.5 million lines of excess material the DoD processes each year for reutilization or disposal, but it is a relatively

small piece of our total logistics operation. Reutilization is a supporting function, and, as we'll discuss later, reutilization and disposal can help the warfighter fulfill the mission by relieving the burden of unneeded materiel, or by helping the warfighter obtain needed materiel. However, programs that more directly support the warfighters' mission remain the primary focus of the Department's logistics efforts.

The mission of the reutilization and disposal function is to ensure that our troops, whether in garrison or forward deployed, have an efficient and user friendly process for disposing of materiel which has reached the end of its useful life or is in excess of that unit's requirements. If the warfighter doesn't need it, the process for turning it in should be as streamlined as possible.

Once materiel has been inducted into our DRMS process, we have three main goals. First, we want the reutilization process to be a source of reusable material for the warfighter provided this materiel can be used without detriment to the mission. If the warfighter cannot use the materiel, it is made available to other DoD components, and then to federal government components, a variety of state and local agencies, disaster relief agencies, and many others. For example, the DRMS was a significant source of no cost materiel provided during the Hurricane Katrina relief efforts, including generators, shelters, and other items.

Second, we want to ensure that materiel with potential military application is properly demilitarized or destroyed. The challenge is finding the right balance between ensuring maximum reuse of materiel by organizations authorized to do so, while ensuring that no unauthorized individuals gain access to militarized materiel. Let me be clear – it

is our policy and our goal that no materiel requiring destruction or demilitarization (“demil”) will be offered for sale or be available under any circumstances to unauthorized persons. Finally, we want to get the best value for the DoD by selling materiel that has no DoD or other authorized user requirement, and that has been completely demilitarized.

The DRMS organization strives to balance these sometimes conflicting objectives. They have shown great responsiveness to the warfighter’s needs by working with our forces to streamline the turn in process while monitoring compliance, balancing the need for accurate turn in data with the warfighter’s need to focus on the mission. They have tried to balance access to excess materiel, in order to increase utilization, with the risks inherent in allowing authorized outsiders to walk through our warehouses. The DRMS staff is dedicated professionals, performing a mission that only gets recognition when something goes wrong, and are to be commended for their service to the Department and the country.

The reutilization and disposal supply chain is a microcosm of the overall DoD supply chain, and mirrors the transformation efforts going on in the overall logistics enterprise. Independent of, but reinforced by, the GAO efforts in this area, DRMS has been reengineering the return portion of the supply enterprise by engaging commercial resources where appropriate, comparing itself to analogous operations in the commercial sector, and initiating a complete systemic review of risk and its mitigation. DRMS is taking a people/process/technology approach to transformation, and Mr. Peters will discuss such improvements as the linking of disposal and materiel procurement systems, the training done both for DRMS and turn in generators in the Military Services, and the

reviews of internal controls at DRMS locations. Full transformation of the DRMS business, however, will require significant rethinking of the way we do business, just as we are doing in the larger supply chain. I urge the GAO and the Committee to give these professionals the time required to complete this transformation.

Even as DoD makes major changes to the DRMS processes, the Department has worked diligently to address the GAO recommendations. In many cases, the recommendations reflected actions already underway, such as linking the supply and disposal systems under DLA's modernization program, and my DLA colleagues will share the excellent results of this effort which was implemented as we promised this Committee in June 2005. GAO itself has praised the responsiveness and progress in addressing the 13 recommendations in the May 2005 report. In fact, as a result of what seemed to a strong working relationship, we have gained valuable insight from the GAO. I appreciate any assistance that helps us improve support to our forces and strengthens our management controls.

Just as we are continuing to reassess our processes and results in all areas of the supply chain, we will continue our efforts in reutilization. Any Fortune 10 size enterprise will have inherent risks, and one engaged in supporting the greatest warfighting force in a changing world will have increased risk. We will continue to both work with the GAO's recommendations and complete our own review and process improvement efforts.

Let me focus on the most significant area that required improvement in the most recent GAO report, which is the sale of items with military-only applications ("demil-required" items) to unauthorized parties, including items which are accessible to the

broader public. All of us at the Department take this matter extremely seriously. We have begun an assessment of our internal controls and procedures to assess how this happened, have already implemented procedures to fix the process, and continue to identify and fix the root causes of the problem. My DLA colleagues will provide further detail, but I know we can count on the support of all the Military Services and Defense agencies to ensure that the problem is fixed. Clearly, we need to follow the policy and procedures we have in place, and constantly review those procedures for vulnerabilities to human error.

There are no new recommendations in the July 10, 2006 report, and we have had concurrence from GAO that we have made significant progress in addressing the 13 recommendations in the May 2005 report. However, GAO indicates in the July 10 report that there are several areas that still need to be addressed. We are reviewing these areas, including process reengineering and tightening of internal controls to ensure proper handling of disposal materiel and the development of processes to ensure appropriate access to DRMS facilities. There are, however, several areas mentioned in the July 10 report in which our current policy and execution is sound, and which are unlikely to change as we reengineer the DRMS process.

Concurrent Buying and Simultaneous Usage

In the last hearing addressing the excess property program, the focus was largely on concurrent buying of materiel from the commercial sector when such materiel was available from DRMS. The Department and the entire reutilization organization have worked diligently to reduce simultaneous buying and disposal. We were pleased to see

that the July 2006 report provides no further examples of concurrent buying, and my colleagues from DLA will describe the progress we have made in linking systems to prevent such concurrent buying, leading to measurable decreases in this practice, and an increase in reutilization of A-coded items considered ready for use.

However, in the most recent report the GAO seems to have broadened the definition of concurrent buying to include items which are requisitioned by units from the supply system while the same item is available on the DRMS Contractor's (Government Liquidation) site. If the item has made it through the various levels of reutilization screening and into the public sale system, it has been determined to be in excess of our retention requirements. In some cases, there still may be requirements for the item – but we have sufficient items in the inventory to meet expected demand. Under these conditions, good business practice dictates that we do not restock the item but attempt to recover whatever value we can for it, even as we continue to issue our remaining stock. There is a cost to inspecting, transporting, restocking and holding materiel that has already been sold from our national inventory.

Further, it would also be counterproductive to our primary mission to mandate in policy that the warfighter must requisition previously owned materiel from the reutilization system. We have built economic incentives to encourage our warfighters to use this materiel, but it must be at the warfighter's discretion where previously used materiel can be utilized safely, and where it poses unacceptable risk to deployed troops. We have policy and process which encourages the reuse of all materiel where feasible.

Materiel Resale Pricing

In its July 10 report, the GAO repeatedly points out the huge difference between the historic cost of acquisition, and the amounts received via the public resale site. While the GAO makes no specific recommendation about how to increase resale revenues, I'd like to explain the reasons for this apparent disparity.

- 1) The items that are offered for resale are materiel in excess of DoD's requirement, and not needed by any of the state and local government agencies, relief organizations or cultural groups which have preferential access to DRMS items. The market for these items will clear at a low price compared to the original purchase precisely because there was no demand in the screening process.
- 2) Original purchase price can be an amount which was paid many years before, for an item, such as electronics in which historic cost of acquisition bears little relationship to its current value.
- 3) The government does not set prices for these items, nor does the DRMS sales support contractor. The prices that the July 10 report references have been set by public auction, an extremely efficient pricing mechanism which reflects the clearing price for the item. The amounts the GAO references as revenues are determined by the market, and thus are a far better indicator of an item's value than its cost of acquisition in the distant past.

Amount of Excess Materiel

The GAO implies that the DoD is ordering more materiel than it needs, and that is why so many new and unused items are available for resale through the disposal system. Balancing overage (too much materiel) and underage (shortages) is the fundamental challenge of any inventory management system, and this is no different at DoD, Target, Wal-Mart or any other organization with inventory. Like any organization, the DoD would like to minimize the amount of excess and obsolete stock it has, and continues to make significant investments in systems, training and new processes to order the right amount of materiel and minimize excess.

However, there is no organization in the world that handles product that does not have excess and obsolete inventory, and does not sell it at a reduced cost. If inventory planning were an exact science, there would be no outlet malls or end of summer sales. As I pointed out in my prior testimony, the cost of a stockout in weapons system parts is far greater than a stock out at Wal-Mart, and we will always plan our inventory levels accordingly.

We Can Still do Better

Since the GAO issued their report in May 2005, the DoD has worked diligently to address many of the specifics of what DRMS is doing to increase its effectiveness. However, I will focus on some of the actions which we believe can lead to better results in our reutilization supply chain without burdening our warfighter with excessive procedural steps. Whatever steps we taking in addressing GAO concerns must not further hinder the work of our warfighters.

1. We will work to improve internal controls in such areas as access to demil-required materiel and to enhance inventory control and accuracy. This is a major area for continued improvement. In doing so, we will use best practices in evaluating risk/reward and cost/benefit tradeoffs for any changes in internal controls, thus balancing our requirement for a user-friendly turn in process with the need for management control of sensitive materiel.
2. We will continue to work to decrease the amount of excess materiel by improving our forecasting, supply base management and logistics processes. We believe that such initiatives as regional inventory management, Radio Frequency Identification (RFID), commodity management and others can lead to greatly improved warfighter support at equal or lower costs to the taxpayer, and that is our primary mission. At the same time, we will use inventory judiciously as a necessary enabling investment in warfighter support.
3. We will fully collaborate with GAO to define a set of performance metrics and internal control reviews focused on the role of disposal and reutilization in relieving the warfighter of the burden of unneeded materiel, assuring public safety, and ensuring reutilization by our forces, other agencies, or the public.

In closing Mr. Chairman, thank you for the opportunity to testify before the Committee about our plans for improving operations and addressing risks in all aspects of DoD logistics, in particular in our excess property program. I would be happy to answer any questions you and the Members of the Committee may have.